FitchRatings

Public Finance
Tax-Supported
U.S.A.

Honolulu (City & County), Hawaii

New Issue Summary

Sale Date: The bonds are scheduled to sell via negotiation on July 21, 2021.

Series: $154,440,000 General Obligation bonds, Series 2021A; $33,450,000 General Obligation Bonds, Series 2021B; $20,060,000 General Obligation Bonds, Series 2021C (Taxable); $36,295,000 General Obligation Bonds, Series 2021D (Honolulu Rail Transit Project); $333,450,000 General Obligation Bonds, Series 2021E (Honolulu Rail Transit Project); $147,690,000 General Obligation Bonds, Series 2022A (Forward Refunding).

Purpose: Proceeds from the series 2021A, B, C, D and E bonds will finance the capital costs of city and county, Honolulu Authority for Rapid Transit (HART) and H-Power projects, purchase equipment, and refund outstanding commercial paper notes issued by the city and council. Proceeds from the series 2022A bonds will refund outstanding GO bonds, series 2012B for interest savings.

Security: The bonds are backed by Honolulu's (the city and county) full faith and credit and supported by an unlimited pledge of ad valorem property tax.

The 'AA+' Issuer Default Rating (IDR) and Stable Rating Outlook reflect the city and county's solid revenue framework, which is dominated by stable property taxes, low long-term liabilities, and robust operating performance. The rating is constrained by the city and county's elevated fixed carrying costs for debt service and retiree benefits, limiting expenditure flexibility.

Key Rating Drivers

Revenue Framework: 'aa': Property taxes account for the majority of general fund revenues, providing a stable revenue source. Fitch Ratings expects solid revenue growth, exceeding inflation but below nominal U.S. GDP growth. The city and county has unlimited independent legal ability to raise property tax revenues.

Expenditure Framework: 'aa': Based on recent spending practices and continued solid revenue performance, Fitch expects that expenditure increases will be in line with to marginally above revenue growth. While fixed carrying costs are elevated, potentially challenging the city and county's ability to reduce expenditures during economic downturns, they also reflect Honolulu's ongoing commitment to address accrued pension and other post-employment benefit (OPEB) liabilities.

Long-Term Liability Burden: 'aaa': Long-term liabilities for debt service and pensions are low at less than 3% of the property tax base. While OPEB liabilities are large and inflexible, statewide reforms to retiree benefits are expected to slow the growth of related liabilities.

Operating Performance: 'aaa': The city and county is well positioned to address economic challenges as a result of its high ability to raise revenues and substantial reserves. Financial management is typically conservative and budgets are consistently balanced.

Rating Sensitivities

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

- Stronger revenue growth prospects;
- Lower fixed carry costs and improved expenditure flexibility.

Ratings

Issuer Default Rating	AA+

New Issues

$154,440,000 General Obligation Bonds, Series 2021A	AA+
$33,450,000 General Obligation Bonds, Series 2021B	AA+
$20,060,000 General Obligation Bonds, Series 2021C (Taxable)	AA+
$36,295,000 General Obligation Bonds, Series 2021D (Honolulu Rail Transit Project)	AA+
$333,450,000 General Obligation Bonds, Series 2021E (Honolulu Rail Transit Project)	AA+
$147,690,000 General Obligation Bonds, Series 2022A (Forward Refunding)	AA+

Outstanding Debt

General Obligation Bonds	AA+

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (May 2021)

Related Research

Fitch Rates Honolulu, HI's $725MM GOs 'AA+'; Outlook Stable (July 2021)

Analysts

Alan Gibson
+1 415 732-7577
alan.gibson@fitchratings.com

Andrew Ward
+1 415 732-5617
andrew.ward@fitchratings.com

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

- Financial flexibility could be pressured by sustained reductions in reserves or expenditure growth that outpaces revenue growth.

Economic Resource Base

The city and county includes the entire island of Oahu, home to over two-thirds of the state's population. While tourism is important, Honolulu is also the state's center for other economic activity, healthcare, defense and government.

The city and county's revenue profile is quite different from the state's. (Fitch's IDR for the state of Hawaii is AA/Stable.) Property tax collections are the largest and most stable single source of city and county revenues, at over three-quarters of general fund revenues, transfers in and other sources in fiscal 2020. By contrast, the state is much more exposed to volatile revenue sources such as general excise tax and transient accommodations tax, which are closely tied to the decision-making of out-of-state visitors, the owners of tourism businesses and airlines.

The expenditure profiles of the city and county and the state are also quite different. While the city and county provides a broad range of municipal services, the state is responsible for cost-intensive education and health and human services. Therefore, while the city and county of Honolulu is clearly a key driver of the state economy, Fitch expects its medium-term financial resilience to be less directly affected by volatile revenue streams and expenditure pressures than the state's.

Current Developments

While proportionately less of Honolulu's nonfarm workforce is in the leisure and hospitality sector (13%) than is the case for the state (15%), it is noticeably higher than in the nation as a whole (9%). Pandemic mitigation efforts' adverse impact on the leisure and hospitality sector has resulted in an unemployment rate that remains uncharacteristically higher (7.2% in April 2021) than the national average (5.7%). However, the unemployment rate has been dropping as the state's tourism industry progressively reopens to very strong demand. The city and county is expecting to return to pre-pandemic levels of tourism in first-quarter 2022, depending on international travel restrictions.

Historically, tax base growth has been strong, with annual increases of between 2% and 10% from fiscal years 2014 to 2020. However, after almost no growth in fiscal 2021, the tax base is projected to shrink by slightly over 1% in fiscal 2022. This is due to downward pressure on some commercial property and hotel valuations, partially offset by ongoing increases in residential property valuations. The tax base will benefit from ongoing construction and strong residential buyer demand.

Credit Profile

Revenue Framework

Property taxes provide the chief source of general fund support for the city and county (over three quarters of fiscal 2020 general fund revenues, transfers in and other sources).

The city and county received $387 million in Coronavirus Aid, Relief and Economic Security (CARES) Act funding and is scheduled to receive approximately $386 million from the American Rescue Plan Act (ARPA), of which $193 million has been received to date. The city and county is also receiving federal emergency rental assistance funding. It does not expect to receive any financial assistance from the state.

In March 2020, the state suspended distribution of the four counties' share of transient accommodations tax, which caused a $45 million revenue loss for Honolulu in fiscal 2021 (2% of general fund expenditures, transfers out and other uses). For fiscal 2022, that funding will be replaced by each county's right to levy its own transient accommodations tax surcharge of up to 3% of gross rental proceeds. For the city and county, this could generate substantially more than $45 million, depending on how it structures the new surcharge.

Rating History

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	7/9/21
AA+	Revised	Stable	4/30/10
AA	Affirmed	Stable	3/24/04
AA	Assigned	—	3/12/99

Fitch expects the city and county's revenue growth, absent policy actions, to increase above inflation but less rapidly than national GDP. While revenue gains may be affected by periodic economic shocks, growth has proven solid on average over the long term.

Hawaii counties have the constitutional power to levy and collect real property taxes, which allows each county to unilaterally adjust its real property tax rates annually with its council's approval. Tax rates are set based on property type, allowing the city and county to meet its fiscal and policy goals, including limiting the tax burden on residents relative to commercial and hotel/resort properties. No tax rate changes are currently planned.

Expenditure Framework

The city and county provides a broad range of municipal services. Public safety and general government account for over half of total general fund expenditures

Fitch expects the natural pace of spending growth to be in line with to marginally above expected revenue growth based on the city and county's current spending profile. In recent years, pension and OPEB cost increases surged as Honolulu worked to bring OPEB contributions in line with actuarial requirements. Having achieved that, city and county officials now project that increases will stabilize at around 3% annually.

The city and county's general fund-supported transit system operating costs will increase as the HART project comes online. When full service begins, the most recent available estimate puts annual operating costs at approximately $127 million. Netting out $40 million of projected annual fare box recovery, the baseline additional cost would be approximately $87 million a year (4% of current governmental spending), which appears manageable given the city and county's revenue-raising flexibility. It is assumed that operating subsidies would be paid from general fund property tax revenues. Such estimates are subject to fare policy, service levels and ridership.

Expenditure flexibility is just adequate, reflecting elevated fixed carrying costs, a public safety-dominated expenditure profile, and limitations on policymaker control over labor costs. Fixed carrying costs related to debt, pensions, and OPEB consumed almost a third of total governmental spending in fiscal 2020 (when adjusted for the enterprise departments), which is notably elevated for a U.S. municipality. The elevated fixed carrying costs are caused in part by efforts to address long-term pension and OPEB liabilities. Fitch's supplemental pension metric, which estimates the annual pension cost based on a level dollar payment for 20 years with a 5% interest rate, indicates that carrying costs are vulnerable to significant future increase. For more information on the supplemental pension metric, see "Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)," dated May 3, 2017.

The city and county's ability to control personnel expenses is somewhat limited by negotiation of contracts at the state level and relatively strong labor protections, including binding arbitration of contract terms for eight bargaining units and the ability to strike for one. However, while state law characterizes arbitration as "final and binding," the city and county can still reject any cost item and force the parties to return to the bargaining table. While the city and county has limited ability to set or adjust terms beyond layoffs and/or furloughs, it does have strong control over headcount.

Long-Term Liability Burden

Excluding the pension liabilities associated with the city and county's enterprise departments, long-term liabilities for debt and pensions are low relative to the property tax base at less than 3% of market valuation and moderately low at 12% of personal income. Since a material portion of the city and county's resource base is excluded from its total personal income given the high level of tourism-related development, Fitch elevates consideration of the property value metric.

Net direct debt of nearly $4 billion makes up just over half of the long-term liability burden. This excludes certain GO bonds issued on behalf of self-supporting city and county enterprises but includes HART-related GO bonds (in the absence of any revenue history for HART). As a city and county, Honolulu has no overlapping debt, and its debt portfolio overwhelmingly comprises fully amortizing, fixed-rate general obligation bonds.

Voter approval is not required to issue debt. The city and county expects debt issuance to follow historical patterns over the next several years with moderate annual issuance for itself. However, its borrowing on behalf of HART will increase due to construction needs; this debt will be repaid from dedicated general excise and transient accommodations tax surcharge revenues. Fitch does not expect future issuance to increase debt to a degree that would pressure the rating given the average pace of amortization as well as tax base and personal income growth prospects in the medium term.

Pensions make up the balance of the long-term liability burden. The city and county participates in the state Employees' Retirement System. The city and county's portion had a 2020 ratio of pension assets to liabilities of about 55% based on an assumed 7% investment return rate and about 48% based on Fitch's standard 6% rate of return assumption. Actuarial contribution rates are determined by statute and adjusted periodically. In recent years the state Legislature has lowered assumed investment returns, extended mortality assumptions and phased in higher employer contribution requirements. While these changes have increased the reported net pension liability and expenses, they have also improved the longer term sustainability of the pension plan.

The city and county's unfunded OPEB liability is about $1.7 billion as of fiscal 2020, less than 1% of market valuation when adjusted for the proportion of unfunded OPEB liabilities supported by enterprises. The city and county made notable progress in funding its OPEB program, moving from pay-as-you-go to full funding of the annual actuarially required contribution within the span of several years. While the state has waived the prefunding portion of counties' OPEB contributions to enhance counties' expenditure flexibility as they recover from the pandemic, the city and county continued to make its full prefunding payment in fiscal 2021 and intends to do so again in fiscal 2022.

The total market value of the OPEB trust fund was $723 million as of June 30, 2020 and is expected to grow in fiscal 2021 due to strong investment gains year to date. Full funding would be a credit positive but is offset by Hawaii local governments' inability under state statute to change OPEB benefits for current members or accrued OPEB liabilities.

Operating Performance

Honolulu benefits from low revenue volatility and would be expected to rebound relatively swiftly from periods of above-average revenue stress.

The unrestricted general fund balance of almost $511 million in fiscal 2020 (over 29% of general fund spending), which the city and county expects to maintain at fiscal 2021 year end, provides a useful cushion against revenue declines, particularly given the city and county's high level of budget control and historically low revenue volatility. While the city and county currently does not have a formal minimum general fund balance policy, Fitch does not anticipate the city and county drawing down its reserves to a level below a 'aaa' reserve safety margin.

The city and county's reserve for fiscal stability fund, held outside the general fund, is available for appropriation only in the event of an emergency or certain economic and revenue triggers. Deposits to this reserve fund are made from general fund and highway fund surpluses. The reserve fund is targeted to be between 5% and 8% of expenditures and grew to almost $137 million in fiscal 2021, with fiscal 2022 budgeting to add a further $7 million.

The city and county does not have liquidity concerns and can access a $100 million commercial paper program for the general fund and a $350 million one for Honolulu Authority for Rapid Transit(HART).

Honolulu Authority for Rapid Transit Project

HART's 20-mile rail transit project is the largest infrastructure investment in state history. The 62% complete project was originally scheduled to open in 2020 but is now expected to be fully operational in the early 2030's, with partial service possible earlier. The project's estimated cost has more than doubled to over $12.4 billion from an initial estimate of $5.1 billion. The $12.4 billion estimate is based on completion of the full system as originally envisaged, conservative risk assumptions and $1.6 billion in contingency funding. Based on that cost estimate, HART projects a budget shortfall of nearly $3.6 billion.

HART, a semi-autonomous agency with new management and a significantly reduced staff, is developing plans to either scale down the project or raise more money to complete the system as originally envisaged. To lower the funding gap, HART is reducing internal costs, identifying construction cost savings, mitigating risks to improve contract pricing and applying for additional federal funding. HART also expects to benefit from better than previously projected general excise and transient accommodations tax surcharge revenues dedicated to the project.

HART estimates there is adequate funding available for all work currently under way, new fiscal 2022 procurements and all outstanding debt repayments, including those related to the upcoming GO bonds. Excluding the $1.6 billion in contingency funding, the remaining funding gap largely relates to construction of the project's last, most complicated segment through downtown to the Ala Moana Center.

ESG Considerations

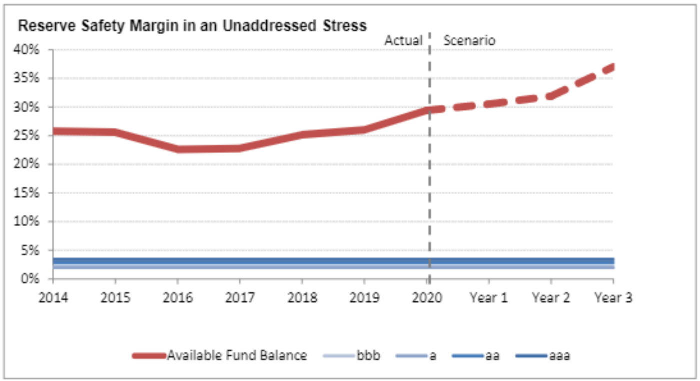
Unless otherwise disclosed in this section, the highest level of environmental, social and governance (ESG) credit relevance is a score of '3' — ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Honolulu (City & County) (HI)

Scenario Analysis

Ver 48



Analyst Interpretation of Scenario Results

Honolulu benefits from low revenue volatility and would be expected to rebound relatively swiftly from periods of above-average revenue stress.

Scenario Parameters:		Year 1	Year 2	Year 3
GDP Assumption (% Change)		(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)		2.0%	2.0%	2.0%
Revenue Output (% Change)	*Min Y1 Stress:* -1% *Case Used:* Moderate	(1.1%)	2.3%	5.7%
Inherent Budget Flexibility			High	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2014	2015	2016	2017	2018	2019	2020	Year 1	Year 2	Year 3
Total Revenues	1,039,068	1,140,345	1,203,597	1,285,573	1,367,297	1,493,311	1,616,598	1,598,253	1,635,121	1,729,114
% Change in Revenues	-	9.7%	5.5%	6.8%	6.4%	9.2%	8.3%	(1.1%)	2.3%	5.7%
Total Expenditures	762,755	830,195	885,055	947,713	997,137	1,068,640	1,132,152	1,154,795	1,177,891	1,201,449
% Change in Expenditures	-	8.8%	6.6%	7.1%	5.2%	7.2%	5.9%	2.0%	2.0%	2.0%
Transfers In and Other Sources	146,729	137,372	182,247	158,670	173,272	192,766	206,169	203,829	208,531	220,518
Transfers Out and Other Uses	434,975	432,795	508,890	485,659	494,558	567,008	605,358	617,465	629,814	642,411
Net Transfers	(288,246)	(295,423)	(326,643)	(326,989)	(321,286)	(374,242)	(399,189)	(413,636)	(421,283)	(421,892)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus/(Deficit) After Transfers	(11,933)	14,727	(8,101)	10,871	48,874	50,429	85,257	29,822	35,947	105,773
Net Operating Surplus/(Deficit) (% of Expend. and Transfers Out)	(1.0%)	1.2%	(0.6%)	0.8%	3.3%	3.1%	4.9%	1.7%	2.0%	5.7%
Unrestricted/Unreserved Fund Balance (General Fund)	308,849	323,576	315,475	326,346	375,220	425,649	510,906	540,728	576,675	682,448
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	308,849	323,576	315,475	326,346	375,220	425,649	510,906	540,728	576,675	682,448
Combined Available Fund Bal. (% of Expend. and Transfers Out)	25.8%	25.6%	22.6%	22.8%	25.2%	26.0%	29.4%	30.5%	31.9%	37.0%

Reserve Safety Margins	Inherent Budget Flexibility				
Moderate	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	18.2%	9.1%	5.7%	3.4%	2.3%
Reserve Safety Margin (aa)	13.6%	6.8%	4.5%	2.8%	2.0%
Reserve Safety Margin (a)	9.1%	4.5%	2.8%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.4%	2.3%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.